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REPORT BY THE

Comptroller General

OF THE UNITED STATES

ORIGINAL COMPLETED

Programs To Control Prescription Drug Costs Under Medicaid And Medicare Could Be Strengthened

In August 1976 the Department of Health and Human Services (HHS) put into effect two programs to control the costs of prescription drugs under Medicaid and Medicare. One program--Maximum Allowable Cost (or MAC)--was designed to take advantage of competition in the drug market by establishing price limits for drugs available from more than one source. This, in turn, involved substituting a lower cost generic drug with the same therapeutic effect for a brand-name drug.

Although GAO did not attempt to settle the scientific disagreements over drug quality and therapeutic equivalence, it did conclude that MAC has resulted in savings under the State-operated Medicaid outpatient drug programs.

This savings could have been greater, however, if (1) States had implemented the limits in a more timely manner, (2) HHS had systematically updated the limits, and (3) HHS had encouraged States to implement or expand their own MAC programs. MAC has had little impact on the cost of drugs under Medicare because those covered under the program are not purchased in large quantities by hospitals.

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REPORT BY THE
COMPTROLLER GENERAL
OF THE UNITED STATES

PROGRAMS TO CONTROL PRESCRIPTION DRUG COSTS UNDER MEDICAID AND MEDICARE COULD BE STRENGTHENED

D I G E S T

Medicaid (a Federal/State-financed activity) pays over $1 billion a year for outpatient prescription drugs for the poor. Medicaid and Medicare (a Federal activity that provides certain health benefits to the aged and some disabled) pay about $750 million a year for prescription drugs provided to hospital inpatients.

Effective August 1976, the Department of Health and Human Services (HHS) established two programs to contain the costs of prescription drugs under Medicaid and Medicare by setting upper limits on the amounts that could be reimbursed. One program, called Maximum Allowable Cost (MAC), pertains to multiple-source drugs and is applicable to Medicaid and Medicare. The other program, called Estimated Acquisition Cost (EAC), pertains to all drugs and is applicable only to Medicaid.

GAO looked into the effectiveness of these programs in five States (California, Florida, Georgia, New Jersey, and Texas) and also obtained information on the effectiveness of State drug substitution laws 1/ nationwide.

1/These laws either permit or require pharmacists to dispense a less costly, but therapeutically equivalent, product under certain circumstances when a brand-name drug is prescribed and pass along all or part of the savings to the customer.

MAC'S EFFECTIVENESS

The MAC program has resulted in savings of about $1.4 million a year under Medicaid for outpatient drugs in the five States; however, the savings could have been greater if:

--States had implemented the MAC limits on a more timely basis and/or, in accordance with regulations, had not claimed Federal sharing for savings lost due to delays in implementation. (See p. 12.)

--HHS had a formal mechanism for systematically updating the limits. GAO analysis showed that about one-third of the MAC limits in effect in June 1979 could have been lower. (See p. 17.)

Although HHS has established an elaborate Medicare regulatory and administrative structure for enforcing the MAC limits for inpatient hospital drugs, the related enforcement requirements have not been adhered to. GAO believes that, even if the program was enforced, it would have little impact on costs because the forms or types of drugs covered by MAC do not appear to be those purchased in large quantities by hospitals. GAO also believes the program could affect costs if it focused on drugs with the greatest cost saving potential in the hospital inpatient setting. (See p. 20.)

EAC'S EFFECTIVENESS

This program was to establish reimbursement limits based on pharmacists' Estimated Acquisition Costs of drugs. One of its objectives was to move the States away from using the published Average Wholesale Prices of drugs for setting such limits. HHS believed that such published prices were from 15 to 18 percent higher than the prices at which druggists could obtain drugs.

GAO found that the States were still using the published wholesale prices to set limits, but the effect of the EAC program's failure to meet its objective is difficult to assess because:

--The HHS data provided to help States establish the EAC often produced limits very similar to the Average Wholesale Prices. (See p. 33.)

--States had their own MAC programs and other special programs for a number of drugs which resulted in lower limits. (See p. 35.)

GAO believes that encouraging State MAC programs and other special EAC programs likely would produce lower drug costs under Medicaid than the EAC program as currently established. Also, some States have reduced drug costs under the EAC program by applying the lower prices for larger package sizes frequently purchased by druggists (see p. 37) and by applying their own MAC limits which were lower than the Federal MACs. (See p. 35.)

IMPACT OF STATE DRUG SUBSTITUTION LAWS

State substitution laws have the potential for significant savings to all consumers. Estimates of such savings nationwide range from $323 million to $817 million a year, depending on the assumptions used. However, actual savings have been less because substitutions have not been made wherever possible.

The States have recognized the potential benefits of substitution laws. As of December 31, 1979, 45 States and the District of Columbia permitted or required substitution under certain circumstances, with over half the States having such statutes since 1976. (See ch. 4.)

RECOMMENDATIONS

HHS should:

--Recover from California and Florida the Federal share of excess costs GAO identified that were due to delays in implementing the MAC limits.

--Require State claims processing systems to identify costs in excess of the MAC limits which are ineligible for Federal sharing.

--Provide for the systematic and formal updating of the MAC limits.

--Reevaluate the applicability of the MAC program to the inpatient hospital setting with the view toward (1) eliminating the existing regulatory and administrative structure which is not being enforced or (2) focusing on the forms or types of drugs which would make the structure worthwhile.

--Encourage the States to (1) review their EAC drug limits to identify drugs that would be suitable for the MAC multiple-source pricing approach on a statewide basis, (2) review the Federal MAC limits to determine whether a lower statewide MAC would be appropriate, (3) determine the package sizes most commonly purchased by pharmacists and adjust their EAC reimbursement limits accordingly, and (4) determine drugs for which it is appropriate to establish EACs based on direct purchase prices and then do so.

As requested by the office of the Subcommittee on Oversight and Investigations, House Committee on Interstate and Foreign Commerce, which asked for this review, GAO did not obtain HHS comments on this report.

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ABBREVIATIONS

AWP	Average Wholesale Price
EAC	Estimated Acquisition Cost
FDA	Food and Drug Administration
FTC	Federal Trade Commission
GAO	General Accounting Office
HCFA	Health Care Financing Administration
HHS	Department of Health and Human Services
MAC	Maximum Allowable Cost